

Your Pension Scheme

The year ahead

APS - April 2009

At a glance

APS, like all UK pension schemes, is required to have a 'financial health check', known as a funding valuation, every three years.

The last valuation was at 31 March 2006 and the results were known at the end of 2006. The 31 March 2009 valuation is underway and must be completed by June 2010.

We are sending you this update to help you understand what the valuation process involves.

The main purposes of the valuation are:

- To check on the 'financial health' of the Scheme and agree an appropriate funding target with British Airways
- To determine the level of contributions required to meet the funding target in an acceptable timeframe
- To understand how the agreed funding plan affects the financial security of member benefits

The valuation process is complex and the Trustees do not expect to be in a position to provide a further update on this process until autumn 2009 at the earliest. Indeed, we may not know the final results until 2010.

The Trustees will be working with their advisers and British Airways over the year ahead to agree a funding plan for APS.

Please note that the Scheme valuation results are distinct from the information that British Airways will disclose in their Annual Report and Accounts documents (likely to be in the summer) as these figures are calculated for a different purpose and under different requirements.

Key Scheme advisers in relation to the valuation

Scheme's Actuary:
Michael Pardoe, Watson Wyatt Ltd

Legal Advisers:
Eversheds

Financial Advisers:
PricewaterhouseCoopers LLP

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In Detail

It is likely that APS will continue to pay pensions to members for a long time into the future and possibly up to the year 2100. Although this is looking a long way ahead, in order to continue to make those payments, we need to get the right balance, over the lifetime of the Scheme, between the Scheme's assets and income on the one hand and its outgoings on the other. The Scheme's income includes contributions from the employers and employees as well as investment returns. The three-yearly valuation is one of the key exercises the Trustees undertake to assess this balance between all of the future payments to be made from the Scheme and all the income that the Scheme expects to receive and to take steps to restore the Scheme to balance where necessary.

Work has already started on the 2009 funding valuation. Although the effective date is 31 March 2009, preparatory work started before that date and the formal deadline for concluding the exercise is June 2010. This sounds like a long time, but the timeframe reflects the complexity of the task and the legal requirements, introduced in 2004, under which the funding valuation is to be carried out. The 2006 valuation was the first to be carried out under the new regime and you might recall that we explained the implications of the new regime in some detail in a series of In Focus communications in 2005-2007. Copies of these documents are available on www.mybapension.com under the 'News' section but we have highlighted some of the key features in Box 1 for you.

Box 1

Key features of the new regime

Assumptions

The Trustees, after taking advice, set the assumptions used in the valuation. These assumptions are used to make predictions about, for example, future investment returns and life expectancy. The more cautious the assumptions, the higher the value placed on the future outgoings and therefore any deficit calculated as part of the valuation process.



What is known about the current funding position?

When we wrote to you about APS in August last year, we reported on how the funding position had changed since the last valuation.

31 March 2006	100%
31 March 2007	102%
31 March 2008	96.5%

Even at that stage the significant change in global economic conditions was evident, as was the adverse impact this was having on APS. The main factor which contributed to the 31 March 2008 estimated funding level of 96.5% was the assumed real investment return, which had reduced as a result of a fall in index-linked bond yields over the year. The effect of this was to increase the value of the assets expected to be needed to meet the liabilities.

Conditions since 31 March 2008

The continuing fallout from the global economic crisis will be the backdrop to the 2009 valuation. There is a great deal of uncertainty and the Trustees will need to understand how the funding position might develop under different economic scenarios and consider how these might flow through to the Scheme's financial position and the impact on the employer's covenant. In addition the Trustees will need to revisit the assumptions made for the life expectancy of Scheme members based on any new evidence and analysis available to them. Once they have reached their conclusions, the Trustees need to agree the assumptions with the Company.

The Employer covenant

The Trustees are also required to make an assessment, which requires extensive professional advice, on the employer's covenant. This means the strength of the company and its ability to pay money to the Scheme as needed to provide existing and future benefits.

Agreement with British Airways

Once the Trustees have decided how to respond to the valuation results, they are required by law to reach agreement with British Airways on those decisions. The Trustees and British Airways need to agree a scheme-specific funding target and a period for making up any deficit, taking account of British Airways' financial strength and ability to pay.

Recovery plan

If the valuation process concludes that there is a deficit in the Scheme (in other words if the assets currently held by the Scheme are less than the amount expected to be needed to provide the benefits) then a recovery plan must be put in place to bring the Scheme back into balance over time. Any recovery plan to repair a deficit will be reviewed by the Pensions Regulator.

Annual updates

Members are provided with annual updates on the funding position of the Scheme.

What can I learn about the potential valuation results from other financial announcements?

Between now and when the final results are known you will probably hear a great deal of speculation about the outcome of the valuation. Please be assured that we will notify you of the results as soon as they are known. This is unlikely to be before the winter and may be later. In the intervening period there will also be some financial announcements which might give you the impression that the funding position is known. This is not the case. In late May British Airways will publish its Annual Report and Accounts. When companies with pension schemes like APS produce their Annual Report and Accounts they are required to use a particular accounting method (IAS19) to assess the position of the fund. This method is based on a standard approach for all companies, which is very different to the way that the Trustees are required to calculate the funding position. The key difference is that the IAS19 method uses the yield on AA-rated corporate bonds to place a present value on the Scheme's liabilities. In contrast, when assessing the Scheme's position for funding purposes, the Trustees will take account of a range of factors, including the anticipated returns on the actual assets held by APS (only a relatively small proportion of which are held in AA bonds).

Later in the year the Trustees will need to produce their own Report and Accounts. Again, this is not a substitute for the funding valuation results. The 31 March 2009 accounts will show the current market value of the assets. This will reflect the income received (member and employer contributions and investment income), the withdrawals from the Scheme (payment of benefits and administration expenses) and the change in market value of investments held over the year as at 31 March 2009. However, it will *not* include an assessment of the amount needed to provide for the Scheme's benefits.

Close

The Trustees recognise how challenging it will be to formulate a funding plan in relation to APS in the current economic environment. We understand our duties and responsibilities and have an expert team of advisers (see front page) who will help us throughout the valuation process. We want to keep you informed of developments and as soon as we are able to do so, will write to you again, to update you on progress. This will probably be in autumn 2009.